



ACQUISITION AND  
TECHNOLOGY

## THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3010

NOV 29, 2000

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS  
ATTENTION: SERVICE ACQUISITION EXECUTIVES  
BALLISTIC MISSILE DEFENSE ORGANIZATION  
ATTENTION: ACQUISITION EXECUTIVE

SUBJECT: Price-Based Acquisition

Section 912c of the National Defense Authorization Act for FY 1998 resulted in chartering a study team to look at implementing price-based acquisition (PBA) within the Department. The study team did an excellent job fleshing out the issues and addressing literally hundreds of questions and comments. Although a consensus among the team was not achieved, the final report adds significantly to the body of knowledge in this area. I accept their report and thank them for their outstanding work. I believe PBA offers great potential and I endorse its use throughout the Department of Defense (DoD).

PBA is one of a number of strategies that we are pursuing to move towards greater access to commercial technologies, products, and processes, as well as to achieve far greater efficiency and effectiveness from our traditional defense suppliers. These objectives are vital to our ability to support the Revolution in Military Affairs and to keep pace with the accelerating advances in technologies worldwide. Various other strategies are being developed to complement PBA. Other strategies will be based on the work of the Lean Aircraft Initiative's work on incentives, and on civil-military industrial integration.

The recommendations made by the PBA report cover a broad spectrum – from early program planning and requirements definition through contract execution. Understanding that the Department could not reach consensus on many of the report's recommendations, but to continue investigating PBA concepts, I request that each Service Acquisition Executive designate at least three programs and the Ballistic Missile Defense Organization Acquisition Executive designate at least one program, to use as test beds for gaining more insight into the application of PBA in research and development and life-cycle support contracts.

Many of the recommendations made by the PBA team can be used today. Others may require regulatory or statutory changes. The DUSD(AR) in consultation with the Office of General Counsel, will work with the program manager of each designated program to identify regulatory and statutory barriers to implementing PBA. Such regulatory barriers will be reviewed to determine if they can be waived for the affected test program. These barriers should not affect the selection of the programs for purposes of implementing the recommendations.

In undertaking this initial effort, I believe we can demonstrate the efficacy of PBA and lay the foundation for its further implementation throughout the Department's acquisition process. An implementation team, made up of representatives from OSD and the Services, will be established to provide assistance, define metrics and report on the progress of each program. These results and lessons learned from each program will provide the framework for a PBA

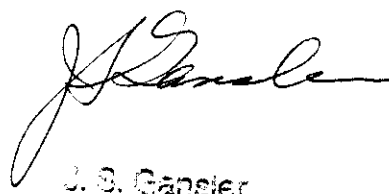


guidebook and knowledge management community available throughout DoD. This will allow the Department to expand the use of these concepts into more programs and identify and justify any needed policy, regulatory, and statutory changes. Centers of Excellence for market research will also be established from lessons learned.

The final report, available at <http://www.acq.osd.mil/ar/doc/pbarpt.pdf>, provides examples of various PBA techniques. The PBA definition and several recommendations from the report, including those that may require statutory or regulatory changes, are located in the attachment. Additionally, the DUSD(AR) is developing distance-learning based training on PBA, and DAU is adapting its curriculum to include PBA principles and techniques.

Please provide the name of your designated programs and the name of the program managers to the DUSD(AR) no later than December 15, 2000. The Deputy Under Secretary's point-of-contact for this request is Mr. Richard Sylvester, phone number 703-697-6399 or e-mail [sylvesr@acq.osd.mil](mailto:sylvesr@acq.osd.mil).

Working together, we can move DoD closer to our goal of giving our warfighters the best available technology faster, and with the use of PBA, at a better price.



J. S. Gansler

Attachment:  
As stated

cc:  
Under Secretary of Defense (Comptroller)  
Assistant Secretary of Defense (Command, Control, Communication, and Intelligence)  
General Counsel of the Department of Defense  
Inspector General of the Department of Defense  
Director, Operational Test and Evaluation  
Directors, Defense Agencies

## **Defining Price-based Acquisition**

**Price-based acquisition is a way for Department of Defense (DoD) to buy goods and services that does not rely primarily on a supplier providing cost data.**

Price-based acquisition (PBA) is a way of doing business that begins with identification of a need and flows through post-award activities. The decision to use a price-based approach is driven by choices made during the Requirements Definition process, is heavily dependent on risk mitigation, the chosen acquisition strategy, and use of competition. In its purest form, PBA results in a firm-fixed-price contract (or fixed-price with performance incentives with incentives not based on cost)

The team concluded that "pure" PBA is at one end of a continuum. At the other end is "pure" cost-based acquisition (CBA) where virtually every aspect of the DoD/supplier relationship demands that the supplier provide DoD with actual or estimated costs.

### **Recommendations**

**1. Consider using an evolutionary and/or incremental development strategy for system development or other acquisition, where risk seems to warrant a cost reimbursable contract.**

An evolutionary approach is a way to more quickly give the user an improved or new capability by fielding it in stages or blocks. The user gets a capability that partially meets the requirement while development and technology maturation continue toward meeting the full requirement. Besides shortening cycle time, an evolutionary strategy is also a technique that allows a program to move forward even when adequate budget or technology is not available to do everything that the user wants. Evolutionary acquisition is also a major enabler for price-based acquisition. Using such a strategy clearly reduces the technical risk of a development program (as compared to a non-evolutionary or single step to full capability strategy) by making it shorter and directed at achieving more modest objectives.

**2. State what the operational user is willing to pay to acquire the capability described in Operational Requirements Documents (ORD) by including a dollar amount in the ORD.**

The user sets the price, based upon such factors as the complexity and urgency of the requirement, the budget, the development community's judgement of what is reasonable, the price for other alternative approaches, the priority of the requirement relative to other competing ones, etc. As the ORD requirements become firm, we expect the price the user is willing to pay will also become firm. The intent is to provide a "check and balance" in the system to ensure program estimates are updated to reflect changing requirements, establish warfighter accountability for the price of the requirement, and help efficiently allocate the limited acquisition monies the Department has available.

**3. Consider either a head-to-head or dissimilar competitive alternative for sole-source major system acquisitions through the life of the program.**

Dissimilar competition should be considered in the acquisition of both system and subsystem production units. It can also be used to apply leverage and to control costs of development

programs, if and only if, viable alternatives exist. Dissimilar competition is an approach that allows DoD to look at competition from a different perspective.

**4. Use production price commitment curves as a means to implement price-based acquisition for sole source production programs.**

Many programs have successfully used application of a production price commitment curve as a means to establish fixed-price production goals during the competitive phase (or early in the development phase of a program) without placing unacceptable risk on the contractor or the Government.

**5. Consider developing Incentive-term contracts.**

Incentive-term is a contract incentive that provides a supplier the opportunity to earn additional contract length for good contract performance. Currently, there is one type of incentive-term incentive, Award Term. The Award Term is a derivative concept of award fee contracts and uses a similar process. The contractor earns additional periods of performance instead of earning award fee for continued successful performance.

**6. Consider the use of implementation of the multi-phase source selection process (may need a waiver).**

A major contributor to program risk is a lack of meaningful communication between the Government and supplier. The result – solicitations containing unrealistic program descriptions and expectations, with little or no consideration given to the cost and/or risk implications associated with the requirements. Consider a source selection strategy that opens the door to the maximum extent possible to full and open communication between the Government and supplier. This strategy, the multi-phase source selection strategy, should be considered whenever the requirement is fluid and is likely to change significantly after information has been exchanged with potential sources and there are two or more sources expected to be capable of meeting the requirements.

**7. Utilize an existing source selection process, the phased down select, where appropriate.**

This phased down-select process is similar in intent to the multi-phase source selection process. That is, to ensure full and open communications between the Government and offerors prior to awarding multi-million dollar contracts, obtain maximum benefits from this open dialogue, and place increased emphasis on up-front planning. These communications are intended to ensure a better understanding of the nature of the problem to be solved, the risk involved, and the opportunities to bring existing capability or commercially-available technology to bear against those risks; thereby, permitting the use of a firm-fixed-price contract. As with the multi-phase source selection strategy, the initial selection of highly rated offerors should be based on an evaluation of the capability statement that includes limited information.

**8. Consider past performance to be at least equal to the highest-ranking factor in source selections valued at greater than or equal to one million dollars.**

Today DoD evaluates past performance much the same way for all acquisitions. The evaluation process relies on a number of inputs: a buyer-generated database of annual Contractor Performance Assessment Reports, phone calls to current and previous customers, mail surveys, etc. Although this may be entirely adequate, it often does not provide discrimination. A past performance evaluation may eliminate a consistently poor performer, but it almost never discriminates among offerors who are otherwise responsive.

**9. Use value-based pricing to determine price reasonableness whenever possible.**

Value-based pricing is the technique of determining the price reasonableness of a product or service based on the quantifiable benefit or utility that a customer derives from consuming it, and is independent of the supplier's actual cost of producing or providing the product or service.

**10. Consider greater use of price analysis using Independent Government Estimates and parametric estimating models for contract modifications.**

The contractor officer is responsible for determining that the price analysis performed is adequate to serve as the basis for determining price reasonableness. If this is achieved, there is no need to obtain and analyze suppliers' cost or pricing data, except when needed to comply with Truth-in-Negotiations Act requirements. The use of price analysis, in lieu of cost analysis, should reduce acquisition lead-time.

**11. Make Fixed-price, Variable Outcome the preferred approach for all Science and Technology and risk reduction contracts, and other contracts where a range of plausible outcomes is possible and acceptable.**

The Fixed-price, Variable Outcome (FPVO) contract depends upon a decision-maker or a decision process (e.g., budget allocation) to determine the value of an acquisition. FPVO can be a useful strategy for fixed-price purchases of engineering services, maintenance, studies, research, risk reduction, and other activities where the procurement is essentially an investment and results other than a well-defined end product are acceptable.

**12. Implement share-in-savings contracts.**

Under a share-in-savings contract, the contractor is paid a proportion of the benefits the contract delivers to the Government. The proportion to be paid is negotiated between the Government and the contractor. The higher the value of actual benefits to the Government, the more the contractor is paid. If no benefits are achieved, the contractor may not be paid at all. The Government pays only for results.

**13. Investigate performance-based payments.**

There are significant advantages to be gained from the use of performance based payments instead of cost-based progress payments. By linking a contractor's financing payments to critical aspects of technical and schedule performance prior to contract award, performance

based payments become an earned value management system. Both contractor and contracting officer will have converted appropriate portions of the program plan and schedule to meaningful criteria used throughout the life of the program.

**14. Create a new termination clause, similar to termination clause used in contracts for commercial items (may require a waiver).**

Under this approach the Department would pay the percentage of the contract price reflecting the percentage of the work performed prior to the termination notice plus reasonable charges. The advantage to this approach is that no cost data is necessarily required, infrastructure savings are gained and the cycle time is reduced.

**15. Encourage the use of clauses such as "Advance Change Adjustment Agreements," whenever practicable.**

This clause eliminates the need to negotiate relatively small dollar changes; thereby, reducing acquisition lead-time and allowing for reductions in both the Government's and the supplier's workforce. The utility of this recommendation will vary with contract type. On fixed-price contracts, suppliers may want relatively low dollar value thresholds in the clause. While this will serve to lower the number of change proposals processed under the clause, it is still valuable.

**16. Incorporate the DoD Value Engineering Program where applicable.**

The Value Engineering Program should be used to promote specific Value Engineering Change Proposals (VECPs) and be considered for non-hardware solutions. VECPs could be developed for the deletion of work that, although ordered, is unnecessary. Reinvesting the savings with the program that generated the savings will greatly motivate program managers to pursue cost reductions.

**17. Investigate the use of Earned Value Management (EVM) in support of financing, termination assessments, contract negotiations, source selection, Planning, Programming and Budgeting System, and continuous process improvements.**

EVM is a criterion-based management approach that has only recently evolved into an industry standard, incorporating guidelines that follow best business practices for project management. It combines integrated cost, schedule and technical performance metrics and also provides commercial firms with tools for cost control and insight into supplier performance.

**18. Establish a liability schedule when initially pricing the contract that lists the damages due the supplier for DoD changes to, and delays in, furnishing property and price delivery schedule extensions when initially pricing the contract.**

This recommendation streamlines post-award administration and eliminates the need for cost information (or cost or pricing data) when obtaining consideration for waivers and deviations granted, in other words, pre-priced contract remedies. When practical, price delivery schedule extensions when initially pricing the contract (liquidated damages clause). This approach will provide an incentive to the contractor to deliver the product or service on time and may increase the amount of consideration the Government collects.

**19. Establish a deduction schedule or curve when initially pricing the contract for waiver or deviation requests.**

Although it is impossible to predict exactly from which requirements the supplier will require waivers or deviations, a schedule could be included in the contract that specifies a change for each minor waiver or deviation (those not affecting form, fit or function). Otherwise, based on prior experience, knowing that a supplier will require some number of waivers or deviations, this contingency could be priced as part of the basic contract with the proviso that such waivers and deviations when granted shall be "no cost."

**20. Utilize Alternative Disputes Resolution (ADR) that can be implemented through a contract clause or Memorandum of Agreement.**

ADR should continue to be promoted for use in resolving disputes. This is a common commercial practice used to avoid or reduce litigation. Already having ADR in place facilitates the use of this procedure as opposed to submission of a contract claim.

**21. Encourage the prime contractor to use a PBA approach with subcontractors to the maximum extent possible, regardless of the arrangement the Government has with that prime contractor.**

In fact, it is not necessary for the Government to have a firm-fixed-price (FFP) contract with the prime contractor in order for the prime to have a FFP contract with its subcontractors. Nor must the Government use a price-based pricing methodology with the prime for it to be used at the subcontract level.